

PUBLIC SERVICE COMMISSION OF WISCONSIN

Memorandum

May 30, 2017

FOR COMMISSION AGENDA

TO: The Commission

FROM: Jeffrey J. Ripp, Administrator
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Division of Energy Regulation

RE: Application of Wisconsin Electric Power Company, 5-DR-112
Wisconsin Gas LLC, and Wisconsin Public Service
Corporation for Declaratory Ruling and Approval Regarding
Long-Term Natural Gas Storage and Transportation
Arrangements

COMMISSION STAFF'S SUPPLEMENTAL COMMENTS

On May 1, 2017, Commission staff issued an agenda memorandum for comment concerning the applicants'¹ request for declaratory rulings concerning the reasonableness and prudence of entering the proposed transaction and its cost recovery mechanism. ([PSC REF#: 302107](#), confidential; [PSC REF#: 302108](#), public.) On May 15, 2017, the applicants, CUB, WIEG and ICE submitted comments on Commission staff's agenda memorandum. ([PSC REF#: 303135](#); [PSC REF#: 303137](#); [PSC REF#: 303141](#), confidential; [PSC REF#: 303142](#), public; [PSC REF#: 303143](#).) On May 23, 2017, the Administrative Law Judge convened a public and party hearing. No members of the public appeared, and no Commission staff or party witnesses were cross-examined. Commission staff submits these supplemental comments in response to the applicants' comments and to one of WIEG's comments to Commission staff's agenda

¹ The abbreviations in Commission staff's supplemental comments have the same meaning as the abbreviations in Commission staff's May 1, 2017, agenda memorandum.

memorandum of May 1, 2017. To assist in the Commission's evaluation and discussion, Commission staff submits a Decision Matrix as Appendix A to these supplemental comments.²

Introduction

The applicants oppose Commission staff's potential conditions proposed in the agenda memorandum of May 1, 2017, because they purportedly relieve the applicants' customers from all risk, are inconsistent with the intent to structure the proposed transaction as if the applicants' owned Bluewater, and would jeopardize WEC's ability to close on the proposed transaction. However, the potential conditions Commission staff proposed are intended to balance risk between the applicants and their customers. Despite the intent to structure the proposed transaction as if the applicants' owned Bluewater, the fact is that WEC, the holding company and affiliated interest of the applicants, will own Bluewater.

The potential conditions Commission staff proposed are intended to ensure that: (1) the applicants are not inappropriately guaranteeing the risk of WEC's investment in a non-regulated asset that operates in a competitive wholesale market; and (2) any risk to the applicants is not transferred in whole to their customers, but rather, is balanced appropriately. *See, e.g.,* Wis. Stat. §§ 196.52 (prohibiting agreements between affiliates that are not reasonable and in the public interest), 196.795(5)(d) (prohibiting public utility affiliate from guaranteeing obligations of nonutility affiliate), and 196.795(5)(f) (prohibiting material subsidization of nonutility affiliate). Given these statutory prohibitions and the applicants' concession that WEC decided to acquire Bluewater for the benefit of the applicants' customers in a structure "that ensured recovery of the facility's costs in a manner that resembles utility ownership," the Commission may find that one or more of the Commission staff proposed conditions are appropriate. While the storage

² The party positions were inserted by Commission staff based upon the filed comments of the parties.

contracts offer the applicants operational benefits of ownership, the applicants do not have the ultimate benefits or responsibilities associated with owning the Bluewater facility. WEC does. In any event, even if it were the case that the applicants were acquiring Bluewater, the Commission may conclude that the potential conditions Commission staff proposed reasonably balance risk and reward equally among shareholders and ratepayers. Such a conclusion would be well-supported by the judicial precedent discussed herein.

In these supplemental comments, Commission staff also seeks to clarify the nature and intent of some of the substance of Commission staff's agenda memorandum of May 1, 2017. Commission staff's discussion of the depreciation rate and acquisition premium assessed the competitiveness of the FERC-approved price of the proposed transaction's storage contracts, which is wholly distinct and unrelated to Commission staff's concern regarding the 60-year length of the proposed transaction's storage contracts. Commission staff's point was simply to evaluate the price as if Bluewater were to be recovered as a traditional rate base asset through the applicants' revenue requirement. Commission staff noted that if Bluewater were the applicants' rate base asset, the storage contract rate may over-recover the cost of Bluewater. While Commission staff found the structure of and data used in the applicants' economic analysis to be appropriate, it did note concerns with several assumptions underlying that economic analysis such as the discount rate, the cost escalation rate, and the 60-year length reflected in the storage contracts. Commission staff stated that recovering the proposed transaction's transportation agreements through the PGAC may be appropriate, but expressed concern regarding recovering the proposed transaction's storage agreements through the PGAC. Instead, Commission staff proposed that the Commission may wish to consider recovering the proposed transaction's

storage agreements through base rates to more appropriately balance risk and reward among ratepayers and shareholders pursuant to the PGAC criteria.

Jurisdictional Conditions

Potential Condition 2 would prohibit the applicants from incurring a charge under the proposed transaction except in accordance with Wisconsin law or from seeking to reflect in rates any cost incurred or revenue earned under the proposed transaction except as permitted by the Commission in this docket. Declaratory rulings are designed to apply a set of facts to a statute or rule the Commission enforces. The applicants assert that because the proposed transaction will ultimately affect their rates, the Commission would exercise its general and ratemaking authority under Wis. Stat. §§ 196.02 and 196.03 in issuing any declaratory rulings. Potential Condition 2 ensures that the applicants do not reflect in rates any costs beyond those contained in the set of facts the Commission must apply to its general and ratemaking authority under Wis. Stat. §§ 196.02 and 196.03 for purposes of issuing the declaratory rulings. Potential Condition 2 in no way authorizes the Commission to disallow rates approved by FERC on the basis that the Commission believes that they are not just and reasonable. Potential Condition 2 does not require a Commission determination that the rates incurred under the storage contract are just and reasonable in any manner whatsoever.

Potential Condition 3 would require provisions in the storage agreements stating that the applicants have entered into them with their affiliate BGS or BGH voluntarily and are not obligated to make any purchases. The applicants' basis for seeking declaratory rulings from the Commission on the reasonableness and prudence of the applicants' decision to enter the storage contracts with their affiliate hinges on their assertion that the applicants have the choice to enter into these storage contracts with their affiliate. If the applicants truly do have the choice to enter

into these storage contracts with their affiliate, there should be no concern with making the fact that they have this choice explicit in the storage contracts themselves. Potential Condition 3 is intended to protect the Commission from a judicial finding that it is preempted from issuing the declaratory rulings that the applicants request.

Potential Condition 4 would prohibit the applicants from asserting the Commission is preempted from assessing the reasonableness and prudence of the applicants' decision to enter the storage contracts with BGS or BGH or related matters in the future. The applicants purport to have no objection to this condition, but assert that any review of the costs or rates under the storage agreements would be preempted and that any Commission reassessment of the reasonableness and prudence of the applicants' entering the proposed storage contracts would be barred by the prohibition on retroactive ratemaking. Potential Condition 4 does not empower the Commission to second guess the justness or reasonableness of the FERC-approved rates contained in the storage contracts or to set rates for a prior period, let alone any period. Rather, Potential Condition 4 prohibits the applicants from asserting that the Commission is preempted from evaluating the reasonableness and prudence of the storage contracts in the future. This is the exact question the applicants are asking the Commission to evaluate now. Before the Commission opened the docket, the applicants submitted a Brief on Jurisdiction and Scope asserting that the Commission is not preempted from evaluating this question.

Last, Potential Condition 5 would require the applicants to file the storage agreements with the Commission for a determination on whether the Commission has jurisdiction under Wis. Stat. § 196.52 before they are filed with FERC. The applicants assert, without any citation to authority or analysis, that Potential Condition 5 is unnecessary because the Commission does not have jurisdiction over the merits of the storage agreements under Wis. Stat. § 196.52. Under

Wis. Stat. § 196.52, however, the applicants and BGS or BGH will undoubtedly be affiliated interests, and the storage agreements will undoubtedly be affiliated interest agreements. In attempting to distinguish the purchase power agreement subject to Commission approval under Wis. Stat. § 196.52 in docket 5-AE-208, the FERC rate for which the Commission did not second guess, the applicants implicitly recognize how the Commission's authority under Wis. Stat. § 196.52 very well applies to the storage contracts.

Economic Analysis

The applicants state that they would not favor a service contract term shorter than 60 years if the Commission felt that 60 years was too long, but would accept a shorter term only if the full investment in Bluewater was recovered over that shorter term. This proposal, which accelerates depreciation, would render the service contract materially more expensive than competing alternatives and is unsupported by any economic analysis. This proposal would also create material intergenerational inequity by compressing the recovery of the \$230 million investment into the early parts of a 60-year economic life of Bluewater.

The applicants state that Commission staff found no deficiencies in the applicants' economic analysis and that this economic analysis demonstrates that the proposed transaction is financially robust. While Commission staff found no deficiencies in the framing of the economic analysis, the quality of the financial model, or the quality of the data used, Commission staff did note concerns regarding the discount rate, the cost escalation rate, and the 60-year length of the storage contracts.

Commission staff noted that a marginal WACC may have been more appropriate for the discount rate in the economic analysis. The applicants state that the marginal WACC would only be appropriate if WEC or the applicants were not intending to dedicate Bluewater to public

utility service. However, the marginal WACC better represents the risks of the investment itself in its full potential, rather than those of any investor or those of the specific use to which Bluewater will be put. The marginal WACC reflects the opportunity costs WEC incurs in implementing the proposed transaction. The marginal WACC, rather than the applicants' blended WACC, reflects the full range of Bluewater's alternative uses and in turn Bluewater's highest and best use. For instance, assuming that the applicants are correct in asserting that the demand for and cost of natural gas storage and transportation are increasing, then contracting with the applicants for 60 years represents a significant opportunity cost to WEC. This opportunity cost to WEC represents WEC not realizing the highest and best use of Bluewater. Bluewater's highest and best use is simply not extinguished by virtue of WEC and the applicants entering the proposed transaction. Some of the potential conditions Commission staff proposed, further discussed below, afford the applicants and WEC the ability to reevaluate the use of Bluewater. These potential conditions do provide WEC with a corresponding benefit and would not leave WEC with any stranded investment.

The applicants further state that Commission staff's evaluation of higher cost escalation rates improperly assumes that Bluewater's costs will escalate at a higher rate than other storage facilities. Commission' staff's evaluation of the higher cost escalation was intended as a sensitivity analysis, demonstrating that if the escalation rate was in fact higher than 3 percent, the net present value of the proposed transaction is significantly reduced. Commission staff's evaluation of the escalation rate demonstrated the importance of that particular assumption to the \$230 million in net present value savings and, therefore, to any conclusion the Commission may reach regarding the reasonableness and prudence of the applicants' entering into 60-year storage contracts. For instance, if the past does not accurately predict the next 60 years, and the

escalation rate is not 3 percent, but something higher, the economics of the proposed transaction may change dramatically. This is not out of the realm of possibility. The applicants' statistics demonstrate that 50 percent of historical rates escalation rates have exceeded 3 percent, and 25 percent of historical escalation rates have exceeded 4.5 percent.

Reopener and Related Conditions

The applicants proposed to seek Commission approval of future capital expenditures at Bluewater in excess of \$7.5 million, which is three times the \$2.5 million threshold for an individual gas utility to seek Commission approval to construct or acquire a new plant. The applicants proposed three times the \$2.5 million threshold because three applicants will be allocated those costs. Commission staff proposed³ a reduction of that threshold from \$7.5 million back to \$2.5 million because the threshold is based on gross cost of new plant. The applicants state that they disagree and that they are aware of instances in which the threshold has been applied based on how a capital investment in a joint-owned asset is allocated between utilities, but do not discuss or cite any such instances. In any event, the applicants nevertheless appear to agree to Commission staff's proposed condition reducing the threshold.

The applicants oppose Potential Conditions 6-9, which would require: (1) reassessing the reasonableness of the proposed gas storage contracts every 10-15 years; (2) including provisions in the gas storage contracts allowing for cancellation or renegotiation; (3) submitting information to determine whether the proposed transaction creates customer savings; and (4) reassessing the reasonableness of any recovery of storage costs through the PGAC every three years. As discussed in Commission staff's agenda memorandum of May 1, 2017, and below, all of these

³ Commission staff's proposed condition here was inadvertently omitted from the list of conditions at the end of Commission staff's agenda memorandum of May 1, 2017. This proposed condition should have been on that list.

proposed conditions are designed to balance risk and benefits equally among ratepayers and shareholders given the 60-year length of the storage contracts and the nature of the industry.

The applicants oppose Potential Conditions 6-9 because they would not be appropriate if the applicants were acquiring Bluewater directly. As noted above, however, the applicants are not acquiring Bluewater directly. Rather, the applicants are entering into storage contracts with their affiliate. Indeed, Wis. Stat § 196.52(5) provides for the Commission's ongoing supervisory control over affiliated interest agreements after their approval. This ongoing supervisory control is intended to "meet the possibility of initial misjudgment or of economic change." Legislation Extending Control Over Public Utility-Affiliate Contracts, 45 Harv. L. Rev. 729, 733 (1932). Potential Conditions 6-9 provide the substantive and procedural vehicles for balancing risk and reward. Reassessing the reasonableness of the storage contracts, with the appropriate information in hand, allows the Commission to determine whether the applicants' participation in the 60-year storage contracts remains in the public interest. The proposed cancellation or renegotiation provision that would be included in the storage contracts provides the Commission, as well as the applicants, a flexible mechanism, among others, to maintain the public interest.

Further, it would be reasonable for the Commission to conclude that Potential Conditions 6-9 are consistent with the applicants' intent to structure the proposed transaction as if they were acquiring Bluewater directly. Stated differently, even if the applicants were acquiring Bluewater directly, the Commission could find that Potential Conditions 6-9 are appropriate. The applicants' assertion that it is at least implicitly recognized that customers bear the risk of obsolescence of utility assets does not appear to be supported by the law. The Court in *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989), upheld a state statute that prohibited return on, and recovery of, investment in assets not used and useful to customers even though they were

prudently acquired. The Court held that utilities are not insulated from prudent, but uneconomic outcomes, whether because of market forces, obsolescence, or bad luck. Rather, the Commission possesses flexibility in addressing non-used and useful assets.

For instance, the Commission can allow recovery of the costs of the asset, but disallow a return on the asset. *United Distrib. Cos. v. FERC*, 88 F.3d 1105, 1179-80 (D.C. Cir. 1996). The Commission can disallow both recovery of the costs of the asset and a return on the asset. *Natural Gas Pipeline of Am. v. FERC*, 765 F.2d 1155, 1163-64 (D.C. Cir. 1985) (“[T]he problem of risk allocation in this case is not a problem of fault. . . . The Natural Gas Act simply does not guarantee the shareholders of even a prudently managed utility that ratepayers can always be stuck with the bill for supply projects that turn out to be total failures, however praiseworthy the utility’s motives for undertaking those projects may have been.”). The Commission could allow both recovery of the cost of the asset and a return on the asset. *United Distrib. Cos.*, 88 F.3d at 1179. Last, if capital expenditures or O&M expenses greatly exceed estimates, the Commission could disallow overruns. *See App. of Wis. Elec. Power. Co for Authority to Increase Rates for Elec., Natural Gas, and Steam Services*, Docket No. 6630-UR-110, at *23 (Pub. Serv. Comm’n of Wis. Apr. 30, 1998) (disallowing cost overruns for the Public Service Building renovation).

Cost Recovery Mechanism

To assist the Commission’s determination as to whether it would be reasonable for the storage contract costs to be recovered through the PGAC, Commission staff noted that recovering the storage contract costs through the PGAC would guarantee recovery of these costs. Commission staff also noted that the true-up component of the storage contract cost may be of particular concern as capital expenditures and O&M costs will be directly passed through to customers and could potentially result in significant increases to the firm storage reservation

charge. For a traditional utility-owned asset, these costs are thoroughly reviewed in the context of a rate case. Commission staff directs the Commission to pages 26 through 28 of the agenda memorandum of May 1, 2017, for further information regarding these issues.

Response to WIEG's Comments

In its comments, WIEG states that recovery of the proposed transaction's costs only from sales customers is appropriate because the applicants have not demonstrated that the proposed transaction will actually provide storage service to transportation customers, nor have the applicants demonstrated that the proposed transaction is an economic storage alternative for transportation customers that have market-based storage options available to them.

WIEG's points are valid. However, Commission staff notes that while the applicants indicated that the proposed transaction would benefit sales customers at the outset, they also indicated that the proposed transaction could benefit transportation customers in the future. For this reason, any Commission decision on which customer classes should pay for the proposed transaction's costs may be premature at this time. Alternatively, if the Commission finds it appropriate to determine which customer classes should pay for the proposed transaction's costs in this docket, the Commission may wish to leave open the possibility of other customer classes paying for the proposed transaction's costs in the future.

AGM:ev:DL:01540090

Key Background Documents

[PSC Paske cover letter and second Commission agenda memorandum for comment - PSC REF#: 302107](#)
[PSC Paske cover letter and second Commission agenda memorandum for comment \(REDACTED COPY\) - PSC REF#: 302108](#)
[CUB's Comments of Staff Memorandum - PSC REF#: 303135](#)
[ICE Initial Comments - PSC REF#: 303137](#)
[Applicant's Comments on Staff Memorandum - PSC REF#: 303141](#)
[Applicant's Comments on Staff Memorandum \(REDACTED COPY\) - PSC REF#: 303142](#)
[WIEG Comments - PSC REF#: 303143](#)

Issue 1: Does the Commission wish to exercise its discretion under Wis. Stat. § 227.41 and issue a declaratory ruling in this proceeding?

Issue Scope: Decisions under Wis. Stat. § 227.41 are entirely within the Commission's discretion; a declaratory ruling is not afforded as a matter of right. Declaratory rulings are based upon a set of facts. The Commission may consider a number of factors, including the scope of the Commission's jurisdiction and authority, when deciding whether to exercise its discretion.

Applicants submit that the Commission has general and ratemaking authority to issue the declaratory rulings regarding the prudence of the proposed transaction under Wis. Stat. §§ 196.02 and 196.03, and cited examples where the Commission has exercised this discretion. *See, e.g., In re Wis. Elec. Power Co.*, Docket No. 6630-DR-104, 2001 WL 1671064 (Pub. Serv. Comm'n of Wis. Oct. 17, 2001); *In re Wis. Pub. Serv. Corp.*, Docket No. 6690-DR-105, 2002 WL 32083055 (Pub. Serv. Comm'n of Wis. Nov. 8, 2002); *In re Wis. Pub. Serv. Corp.*, Docket No. 6690-DR-107, 2003 WL 22683461 (Pub. Serv. Comm'n of Wis. Nov. 12, 2003); *In re Kewaunee Nuclear Power Plant*, Docket No. 5-EI-136, 2005 WL 937257 (Pub. Serv. Comm'n of Wis. Apr. 21, 2005). There are also examples where the Commission has declined to grant such declarations. *See, e.g., In re Wis. Elec. Power Co.*, Docket No. 6630-EI-113, 2007 WL 2846904 (Pub. Serv. Comm'n of Wis. Sept. 25, 2007); *In re City of Columbus Water & Light Dep't*, Docket No. 1300-DR-100, 2006 WL 2474232 (Pub. Serv. Comm'n of Wis. June 26, 2006); *App. of Wis. Power & Light Co. for a Decl. Ruling on the Issues of the Revenue Requirement Treatment of Proposed Generation Plant*, Docket No. 6680-DR-106, 2000 WL 36274837 (Pub. Serv. Comm'n of Wis. Aug. 18, 2000). Applicants distinguish cases that raise potential concerns regarding federal preemption on the basis that the applicants have a choice among suppliers, including their future affiliate. *Pike Cnty. Light and Power Co. v. Pa. Pub. Util. Comm'n*, 465 A.2d 735 (1983); *Ky. W. Va. Gas Co. v. Pa. Pub. Util. Comm'n*, 837 F.3d 600 (3d. Cir. 1988).

Commission staff proposed a number of conditions that the Commission may wish to consider if it believes the conditions are necessary to ensure that any declaratory ruling issued by the Commission would be within the Commission's authority and consistent with Wis. Stat. § 227.41. These conditions include:

Proposed Condition 1: The declaratory rulings are strictly based on the set of facts established in this proceeding, are only valid to the extent that the set of facts remains in place, and are void to the extent that the set of facts changes.

Proposed Condition 2: The applicants are prohibited from incurring a charge under the proposed transaction except in accordance with Wisconsin law or from seeking to reflect in rates any cost incurred or revenue earned under the proposed transaction except as permitted by the Commission in this docket.

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Proposed Condition 3: The applicants must include provisions in the storage service agreements stating that the applicants have entered into them with their affiliate BGS or BGH voluntarily and are not obligated to make any purchases.

Proposed Condition 4: The applicants are prohibited from asserting that the Commission is preempted from assessing the reasonableness and prudence of the applicants' decision to enter into the service storage agreements with BGS or BGH or related matters in the future.

Proposed Condition 5: The applicants are required to file with the Commission the storage service agreements with their affiliate BGS or BGH before filing them with FERC in order for the Commission to determine, with the cooperation of the applicants, whether it has jurisdiction under Wis. Stat. § 196.52.

PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
Applicants : Grant the requested declaratory ruling without Proposed Conditions 2 through 5 because: Proposed Condition 2 is preempted; Proposed Condition 3 is not applicable because the applicants do not have a choice once they enter into the contracts or is otherwise preempted; Proposed Condition 4 is not necessarily objectionable though any review of costs or rates under the agreements is preempted; and Proposed Condition 5 is unnecessary because the Commission does not have jurisdiction to review the merits of the agreements under Wis. Stat. § 196.52.	N/A	Applicants' Comments on Staff Memorandum, at 8-10.
CUB : Supports Proposed Conditions 1-5.		CUB Comments on Memorandum, at 10-11.
ICE : Raises concerns that "the jurisdiction of the Commission is being eroded by shifting transactions and assets outside of the regulatory control of the Commission . . ." and that "any declaratory ruling by the Commission should include a condition that all ratepayer protections provided by Wis. Stat. § 196.52(4) and Wis. Stat. § 196.52(5) will apply to the agreement going forward . . ."		ICE Comments, at 1.

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Commission Staff: The Commission may wish to consider imposing some or all of Proposed Conditions 1 through 5 if it believes any such conditions are necessary to ensure that any declaratory ruling issued by the Commission would be within the Commission's authority and consistent with Wis. Stat. § 227.41. Proposed Condition 2 is not preempted because it does not require a Commission determination that the rates incurred under the contracts are just and reasonable. Proposed Condition 3 simply memorializes the applicants' representation that the utility affiliates truly have a choice in entering into the contracts. Proposed Condition 4 protects the Commission from a future assertion that it is not preempted in the future from reviewing the reasonableness or prudence of the transaction. Proposed Condition 5 is also not preempted because the Commission does have jurisdiction under Wis. Stat. § 196.52, just as it did in docket 5-AE-208, because the applicants and BGS or BGH will be affiliated interests.		Commission Agenda Memorandum dated May 1, 2017 (Agenda Memo), at 11-14; Commission Agenda Memorandum dated May 30, 2017 (Supp. Agenda Memo), at 4-6.
COMMISSION ALTERNATIVES		
Alternative One: Issue a declaratory ruling without Proposed Conditions 2 through 5.		
Alternative Two: Issue a declaratory ruling with Proposed Conditions 2, 3, 4 and/or 5.		
Alternative Three: Decline to issue the requested declaratory ruling.		
Notes:		

Issue 2: Is it reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements?

Issue Scope: When deciding whether it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements, the Commission may wish to consider the assumptions and results of the applicants' economic analysis, as well as the balance of risk between the holding company, the applicants, and the ratepayers of the proposed transaction as structured.

Applicants submit that the economic analysis demonstrates that the proposed transaction will provide \$200 million in NPV savings to customers. Commission staff did not identify any deficiencies in the framing of the economic analysis, the quality of the financial model, or the quality of the data used. Commission did, however, identify concerns the Commission may wish to consider regarding the discount rate, the 60-year length of the storage contracts, and the cost escalation rate.

Commission staff has proposed a number of conditions that the Commission may wish to consider if it finds it necessary to ensure that the applicants are not inappropriately guaranteeing the risk of the holding company investment in a non-regulated asset consistent with Wis. Stat. §§ 196.52, 196.795(5)(d), and 196.795(5)(f), and that any risk is balanced appropriately. These proposed conditions include:

Proposed Condition 6: Under its authority in Wis. Stat. § 196.52, the Commission will reassess reasonableness of the proposed gas storage contracts every 10 or 15 years based on any potential changes to the natural gas market, the applicants' industry, the applicants' customer needs, and the regulatory, business, and legal environment within which the applicants operate.

Proposed Condition 7: The applicants are required to include provisions in the gas storage contracts allowing for cancellation or renegotiation if events materially affecting the economic savings of the proposed transaction occur.

Proposed Condition 8: The applicants are required to periodically submit information that would allow Commission staff to verify that the proposed transaction is in fact creating customer savings.

Proposed Condition 9: The Commission will reassess the reasonableness of recovering gas storage contracts costs through the PGACs under the used and useful standard every 3 years.

The Commission may wish to defer a decision on Issue 2 until after its discussion of Issues 2.A., 2.B., and 2.C.

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PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
<p>Applicants: It is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements. Even after “stress testing” the economic analysis applying alternative assumptions unfavorable to the proposal, Commission staff found that the proposal will benefit customers in all but the most extreme worst case scenarios. All of the proposed conditions are unnecessary and would be inconsistent with the intent and structure of the proposal and would jeopardize WEC’s ability to close on the transaction. The proposed conditions would inappropriately shift risk and responsibilities to WEC and its shareholders without any corresponding benefit.</p> <p>Applicants offer modifications to the Proposed Conditions to further ensure that their customers bear the same balance of cost, risk and benefit that the applicants do with a utility-owned asset. These modifications include: acceptance of a term of less than 60 years, provided that the full investment in the Bluewater storage facility is recovered over that same term; would reduce the threshold for capital expenditures to \$2.5 million instead of \$7.5 million, provided that the Commission makes clear in its order that it is making no determination as to the application of the cost threshold to individual utilities under Wis. Stat. § 196.49(5g)(ar)1m.; and the Commission otherwise confirms the reasonableness and prudence of the applicants entering into the proposed gas storage and transportation arrangements without conditioning the applicants’ future recovery of their costs.</p>	N/A	Applicants’ Comments on Staff Memorandum, at 2, 3-4, 13-17.
<p>CUB: Commission staff’s review of the applicants’ economic analysis indicates a possibly significantly lower NPV than the \$200 million base case calculated by the applicants. If correct, the risks to ratepayers may not be justified by the NPV. Supports Proposed Conditions 6, 7 and 8.</p>		CUB Comments on Memorandum, at 3, 7.

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<p>Commission Staff: The Commission may wish to consider the imposition of some or all of Proposed Conditions 6 through 9 if it believes any such conditions are necessary to ensure that the risk of the transaction is balanced appropriately. WEC, not the applicants, is purchasing the Bluewater facility. Even if the applicants were purchasing the Bluewater facility directly, it would still be reasonable for the Commission to impose such conditions because the Commission has flexibility in addressing non-used and useful assets.</p>		<p>Agenda Memo., at 16-22; Supp. Agenda Memo., at 2-3, 6-10.</p>
<p>COMMISSION ALTERNATIVES</p>		
<p>Alternative One: Declare that it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements without the imposition of any conditions.</p>		
<p>Alternative Two: Declare that it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements, but impose one or more of the applicants' proposed modified conditions.</p>		
<p>Alternative Three: Declare that it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements, but impose one or more of the conditions proposed by Commission staff.</p>		
<p>Alternative Four: Declare that it is not reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements.</p>		
<p>Notes:</p>		

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Issue 2.A.: Is the discount rate assumed by the applicants reasonable?		
Issue Scope: Applicants used a blended weighted average cost of capital (WACC) based on their most recent rate cases, which is equal to 7.19 percent.		
PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
Applicants: The use of the blended WACC is reasonable. A marginal discount rate would be appropriate only if WEC or the Gas Utilities were proposing to acquire Bluewater and continue operating it to provide storage to third parties in interstate commerce. Because the Gas Utilities are proposing to dedicate Bluewater to retail public utility service, a marginal discount rate overstates the risk associated with the acquisition.	N/A	Applicants Comments on Staff Memorandum, at 11.
Commission Staff: The blended 7.19 percent WACC may be understated. The marginal WACC may be a more appropriate discount rate to be used in this economic analysis because it represents the risks of the investment in its full potential, rather than those of any investor or those of the specific use to which Bluewater will be put; reflects the opportunity costs WEC incurs in implementing the proposed transaction; and reflects the full range of Bluewater's alternative uses and, in turn, its highest and best use. If the Commission has concerns about the discount rate used, it could consider imposition of one or more of the Proposed Conditions.		Agenda Memo., at 16-18; Supp. Agenda Memo., at 6-10.
COMMISSION ALTERNATIVES		
Alternative One: Find that the discount rate assumed by applicants is reasonable.		
Alternative Two: Find that the discount rate assumed by the applicants is not reasonable, and impose Proposed Condition 6, 7, 8 and/or 9 to balance risk.		
Alternative Three: Decline to make a specific finding as to the reasonableness of this assumption, but consider this, among other factors, when determining whether it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements.		
Notes:		

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Issue 2.B.: Is the 60-year length of the gas storage contracts reasonable?		
Issue Scope: The proposed term of the gas storage service agreements is 60 years.		
PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
Applicants: The proposed 60-year term is reasonable. If the Commission determines a shorter or longer term is reasonable, then applicants would accept the term and make the appropriate changes to the agreements, provided that the full investment in the Bluewater facility is recovered over that same term. Applicants opposed Commissions staff's proposed conditions.	N/A	Applicants' Comments on Staff Memorandum, at 3
Commission Staff: 60 years is a significantly long period of time and this may create greater uncertainty and risk. Recovering the full investment in the Bluewater facility accelerates depreciation, would render the service contract materially more expensive than competing alternatives, and is unsupported by any economic analysis. If the Commission is concerned with the length of the contract, it could impose one or more of the Proposed Conditions 6 through 9.		Agenda Memo., at 18-21; Supp. Agenda Memo., at 6-10.
COMMISSION ALTERNATIVES		
Alternative One: Find that proposed length of the contracts is reasonable.		
Alternative Two: Find that the proposed length of the contracts is not reasonable, and adopt applicants' proposal to shorten the length and allow that the full investment be recovered over the same term.		
Alternative Three: Find that the proposed length of the contracts is not reasonable and impose Proposed Condition 6, 7, 8 and/or 9 to balance risk.		
Alternative Four: Decline to make a finding as to the reasonableness of the length of the contracts, but consider this, among other factors, when determining whether it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements.		
Notes:		

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Issue 2.C.: Are the capital expenditures growth rate assumptions reasonable?		
<p>Issue Scope: Applicants used an annual capital expenditures growth rate of 3 percent throughout the life of the proposed transaction. Applicants also used a straight line growth rate.</p> <p>The NPV savings is very sensitive to the growth rate in operations, maintenance, and capital expenditures. Commission staff studied the impact of three higher growth rates in the applicants' economic model to test its potential impact on the economic viability of the proposed transaction. Using a growth rate of 5 percent would result in \$133 million, or 18 percent, in NPV savings. Using a growth rate of 7 percent would result in \$11 million, or 2 percent, NPV savings. And using a growth rate of 9 percent would result in (-\$245 million), or (-34 percent), in NPV savings.</p>		
PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
<p>Applicants: The growth rate assumptions are reasonable. Commission staff's study of higher cost escalation rates is incomplete because the higher rates were applied only to Bluewater's costs. Regardless, Commission staff's stress testing shows that the proposal will generate savings in all but the most extreme cases in which Bluewater's costs escalate at 9 percent for 60 years while the cost of other storage in the market increases at only 3 percent.</p>	N/A	Applicants Comments on Staff Memo., at 11-12.
<p>Commission Staff: Commission staff's evaluation of the escalation rate demonstrates the importance of this particular assumption to the NPV and to any conclusion the Commission may reach regarding the reasonableness and prudence of the applicants' entering into 60-year storage contracts.</p>		Agenda Memo., at 21-22; Supp. Agenda Memo., at 7-8.
COMMISSION ALTERNATIVES		
<p>Alternative One: The applicants' assumed capital expenditure growth rate assumption is reasonable.</p>		
<p>Alternative Two: The applicants' assumed capital expenditure growth rate assumption is not reasonable and impose Proposed Condition 6, 7, 8 and/or 9 to balance risk.</p>		
<p>Alternative Three: Decline to make a specific finding as the reasonableness of this assumption, but consider this, among other factors, when determining whether it is reasonable and prudent for the applicants to enter into the long-term storage service and interstate gas transportation agreements.</p>		
<p>Notes:</p>		

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Issue 3: What should the cost threshold be triggering Commission review and approval for recovery in rates for capital expenditures at the Bluewater facility?

Issue Scope: Applicants proposed that the Commission will have an opportunity to review and approve the recovery in rates of material capital expenditures, which the applicants define as those in excess of \$7.5 million. The applicants determined this amount based on the current Certificate of Authority (CA) natural gas threshold of \$2.5 million multiplied by three since there are three applicants.

Commission staff proposed that the Commission consider reducing the cost threshold for approval of future capital expenditures threshold from \$7.5 million to \$2.5 million.*

*This proposed condition was inadvertently omitted from the list of conditions at the end of the Agenda Memo.

PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
Applicants: Applicants would agree to reduce the threshold for capital expenditures to \$2.5 million instead of \$7.5 million, provided that the Commission makes clear in its order that it is making no determination as to the application of the cost threshold to individual utilities under Wis. Stat. § 196.49(5g)(ar)1m.	N/A	Applicants Comments on Staff Memo., at 7-8.
Commission Staff: Reducing the threshold would be consistent with Wis. Stat. § 196.49(5g)(ar)1m which establishes that the estimated gross cost of a proposed project is to be used when determining whether a project exceeds the CA cost threshold.		Agenda Memo., at 6-7; Supp. Agenda Memo., at 8.

COMMISSION ALTERNATIVES

Alternative One: Reduce the cost threshold with the clarifications requested by the applicants.

Alternative Two: Reduce the cost threshold without the requested clarifications.

Alternative Three: Do not reduce the cost threshold.

Notes:

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Issue 4: Is it reasonable and prudent for the applicants to recover their allocated portion of the costs to acquire, operate and maintain the Bluewater facility in their purchase gas adjustment clause (PGAC)?

Issue Scope: Applicants propose to recover firm storage reservation charges and transportation contract charges through their respective PGAC. The Commission developed PGACs to correct over-recovery or under-recovery of commodity-related gas costs, which generally include storage and transportation costs (but not plant or other assets) either because of changes in the cost of gas supplies or customer usage different than anticipated in base rates.

One of the criteria for recovery of a cost through the PGAC is that such recovery balances the sharing of risk and reward between shareholders and ratepayers. The applicants believe that recovering the storage and transportation costs associated with the Bluewater facility through the PGAC is appropriate because shareholders forego the opportunity to invest capital elsewhere for 60 years, while ratepayers acquire storage facilities at costs consistent with other utility investments.

Commission staff did not have any concern with recovering the proposed transportation contracts through the PGAC, but did identify a potential area of concern with recovering the storage contracts through the PGAC in that ratepayers may bear all the risk associated with the 60-year contracts, and the applicants would be guaranteed recovery regardless of how the market may change. If the Commission decides that recovery of the storage contracts through the PGAC is appropriate, Commission staff proposed a condition under which the Commission would reevaluate the storage contracts under a used and useful standard every 3 years.

Commission staff further proposed that the Commission may wish to recover the storage contracts through base rates, rather than the PGAC, which may more appropriately balance risk and reward. If the Commission decides that the storage contracts should be recovered strictly through base rates, Commission staff proposed treating the proposed transaction as an operating lease on the applicants' books, which allows the applicants to reflect their interest in the storage facilities without implying ownership. If the Commission finds that it is reasonable and prudent to recover the storage contract costs through base rates, Commission staff proposed that the Commission may wish to allow the applicants to either defer the costs or recover them through their PGACs until each of the applicant's next full rate case.

PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
Applicants: Recovery of the proposed transactions transportation and storage costs through the PGAC is appropriate because under the proposed transaction, reliable service would be maintained; the sharing of risk and reward would be balanced between shareholders and ratepayers; appropriate price signals would be sent; the transition to workable markets	N/A	Application, at 27; Applicants Comments on Staff Memo., at 18-20.

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<p>will not be unduly hindered; the lowest reasonable cost of gas will be achieved; the Commission will have detailed and timely information; and the need for retrospective review of utility transactions will be minimized. Commission staff's proposed reevaluation condition is unnecessary. In the event that the Commission determined in the future that it would be reasonable to move the recovery of certain costs from the PGACs to base rates (or vice versa), there must be an opportunity for the Gas Utilities to change their base rates accordingly. Because this is usually only possible during a base rate case and because base rate cases do not occur on a triennial basis, a triennial review of PGACs could lead to timing discrepancies resulting in deferrals of costs or refunds. The Gas Utilities recommend that any Commission review of PGAC scope take place in base rate proceedings where both base and PGAC rates are determined concurrently.</p>		
<p>CUB: To the extent that cost recovery is independent of the applicants' base rate cases and is essentially guaranteed, it appears that the applicants would lack any incentive to work with their affiliate to keep costs low or to seek additional revenues from opportunity sales. Recovery of storage costs through base rates will allow the Commission to set natural gas rates based on applicants' load and total costs, rather than total rate case costs minus BGH storage agreement costs. It would seem this would give the Commission the flexibility to push some total gas revenue requirement cost back onto shareholders to the extent total costs are not supported by total load. In exchange for this cost risk sharing, shareholders would retain any opportunity sales and benefits from increased sales. If the Commission agrees storage agreement costs must be recovered in rate cases, then CUB suggests the Commission order storage agreement costs be deferred, with carrying costs at the short-term debt rate, until each applicant's next full rate case. Alternatively, if the Commission adopts applicants' proposal to use the PGAC, CUB supports the proposed used and useful review of the storage agreements every 3 years. It is unclear to CUB whether such a used and useful review provides the same certainty</p>		<p>CUB Comments on Memorandum, at 8-11.</p>

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and robustness of ratepayer protection as staff identifies if storage costs are recovered through the rate case process.		
WIEG: WIEG is indifferent to whether the proposed transaction's costs are recovered through the PGAC or through base rates.		WIEG Comments on Agenda Memo., at 3.
Commission Staff: If the applicants are permitted to recover the gas storage contracts on a one-for-one basis through their PGACs, the applicants' ratepayers bear all the risk associated with the 60-year contracts. The applicants would be guaranteed recovery of all charges incurred under the gas storage contracts regardless of how the market may change, and the ratepayers would be required to pay for such contracts even if they prove uneconomic in the future. If the Commission determines that recovery of storage costs through the PGAC is appropriate, it may wish to reevaluate that decision every 3 years under the used and useful standard. Recovery of gas storage agreement costs through base rates may more appropriately balance risk and reward among shareholders and ratepayers. Including these gas storage contract costs in base rates does not guarantee full recovery of all costs, but would allow the applicants a reasonable opportunity to recover prudently incurred costs under their contracts. If the Commission decides that the storage contract costs be recovered strictly through base rates, treatment of the proposed transaction as an operating lease on the applicants' books allows the applicants to reflect their interest in the storage facilities without implying ownership. If the Commission finds that it is reasonable and prudent to recover the gas storage contract costs through base rates, the Commission may wish to allow the applicants to either defer the costs or recover them through their PGACs until each of the applicant's next full rate case.		Agenda Memo., at 26-31; Supp. Agenda Memo., at 10-11.
COMMISSION ALTERNATIVES		
Alternative One: Recover the storage contracts through the PGAC without Commission staff's proposed reevaluation condition.		
Alternative Two: Recover the storage contracts through the PGAC with Commission staff's proposed reevaluation condition.		
Alternative Three: Recover the storage contracts as an operating lease through base rates, with either deferral until the applicants' next rate cases or recovery through the PGAC until the applicants' next rate cases.		
Notes:		

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Issue 5: Is it reasonable to recover the proposed transaction's costs only from sales customers?		
Issue Scope: Applicants propose to initially recover their net storage costs from retail sales based upon annual demand requirements, but may propose in future rate proceedings to collect a portion of the net Bluewater storage costs from transportation customers as an appropriate cost of providing daily balancing service.		
PARTY POSITIONS	AMOUNT*	TRANSCRIPT REFERENCES
Applicants: Because the Gas Utilities will have access to their contracted storage for balancing throughout the year, the Gas Utilities propose to initially recover their net storage costs from retail sales based upon annual demand requirements. The Gas Utilities may propose in future rate proceedings to collect a portion of the net Bluewater storage costs from transportation customers as an appropriate cost of providing daily balancing service.	N/A	Application, at 27.
WIEG: WIEG supports the applicants' proposal to recover the cost of the Proposed Transaction only from sales customers and not transportation customers, whether cost recovery occurs via the Gas Utilities' respective PGAs or base rates. Recovery of the Proposed Transaction costs only from sales customers is appropriate because the Gas Utilities have not demonstrated that the Proposed Transaction will actually provide storage service to transportation customers, nor have the Gas Utilities demonstrated that the Proposed Transaction is an economic storage alternative for transportation customers that have market-based storage options available to them. As a result, it is appropriate to collect the Proposed Transaction acquisition costs only from sales customers. It would be inappropriate for the Gas Utilities to force transportation customers of the Gas Utilities to pay for storage service from the Bluewater facility in lieu of market-based options available to transportation customers.		WIEG Comments on Agenda Memo., at 3-4.
Commission Staff: WIEG's points are valid. However, Commission staff notes that while the applicants indicated that the proposed transaction would benefit sales customers at the outset, they also indicated that the proposed transaction could benefit transportation customers in the future.		Supp. Agenda Memo., at 11.

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For this reason, any Commission decision on which customer classes should pay for the proposed transaction's costs may be premature at this time. Alternatively, if the Commission finds it appropriate to determine which customer classes should pay for the proposed transaction's costs in this docket, the Commission may wish to leave open the possibility of other customer classes paying for the proposed transaction's costs in the future.		
COMMISSION ALTERNATIVES		
Alternative One: Recover the proposed transaction's costs only from sales customers.		
Alternative Two: Recover the proposed transaction's costs only from sales customers now, but leave open the possibility of recovering from transportation customers in the future.		
Alternative Three: Decline to expressly decide which customer classes should pay for the proposed transaction's costs in this docket.		
Notes:		

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